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Supreme Court of the United States

OCTOBER TERM, 1934.

No. 340.

OLD COMPANY'S LEHIGH, INC., *Petitioner,*

vs.

HENRY E. MEEKER, as Receiver of the First National Bank in Mamaroneck, THE FIRST NATIONAL BANK IN MAMARONECK, and R. G. BREWER, INC., *Respondent.*

BRIEF OF RESPONDENT.

JOHN F. ANDERSON,
HUMPHREY J. LYNCH,
Attorneys for Respondent.

F. G. AWALT,
GEORGE P. BARSE,
Attorneys for Comptroller of the Currency,
Of Counsel.

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(A) Where, as in the instant case, and in the companion cases Nos. 338 and 374 set for argument immediately before and after the instant case, a claimant seeks to recover from the Receiver of an insolvent National bank money alleged to have been held by the bank on a trust, he must affirmatively establish under the unmistakable trend and weight of Federal decisions, (1) that his transaction with the bank has resulted in a trust relationship; (2) that the assets of the bank have been augmented or increased by new cash or property accruing from the claimant; and (3) that the new property, in its original or changed form, can be traced into the assets taken over by the Receiver at suspension. No augmentation occurs hence no trust relationship or tracing exist where the transaction results only in a shifting of bookkeeping credits on the books of the now insolvent National bank.

In the instant case the collecting bank never received by way of proceeds of the note, an identifiable res, an essential to the creation of a trust. Its assets were not augmented because the collection proceeds consisted of a check drawn against a general deposit balance already in the now insolvent National

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(B) Where, as in the instant case, the record facts establish that neither trust relationship, augmentation, nor tracing of funds appear, the rights of the claimant against an insolvent National bank are in no way increased by the provisions of Sec. 350-L, and subd. 2, art. 19-A of the New York Negotiable Instruments Law, which, in language, is the same as Section 13 of the Bank Collection Code and will be referred to by the latter title hereafter 19

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BRIEF OF RESPONDENT.

I.

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals for the Second Circuit is reported in 71 Fed. (2nd) 280 (R. 23 to 27). The opinions of the District Court are set out in the record pages 7 and 17.

II.

JURISDICTION.

Writ of certiorari was granted on October 8, 1934 (R. 29), under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925 (U. S. C. Title 28, Section 347).

III.

STATEMENT OF CASE.

The respondent makes no objection to the statement of the case set out in the petitioner's brief on the merits. The case before this court can be briefly stated as follows: The petitioner seeks a reversal of the decision of the Circuit Court of Appeals for the Second Circuit, affirming the action of the United States District Court for the Southern District of New York in dismissing, as to the respondent, the petitioner's action in equity, seeking to establish a trust against the assets of the First National Bank in Mamaroneck, New York, insolvent, based on general principles of equity and the provisions of Sec. 350-L, subd. 2, art. 19-A of the New York Negotiable Instruments Law which is, in language, the same as Section 13 of the Bank Collection Code. On January 14, 1933, the last day the respondent bank did business as a solvent institution it surrendered to R. G. Brewer, Inc., a note in the amount of $3000 made by that company, owned by the petitioner and in the hands of the bank as sub agent to collect and remit, in exchange for the note debtor's check drawn against a general deposit balance already in this bank, and failed to remit the proceeds.

IV.

SUMMARY OF ARGUMENT.

(A) Where, as in the instant case, a claimant seeks to recover from the Receiver of an insolvent National bank money alleged to have been held by the bank on a trust, he must affirmatively establish under the unmistakable trend and weight of Federal decisions, (1) that his transaction with the bank has resulted in a trust relationship; (2) that the assets of the bank have been augmented or increased by new cash or property accruing from the claimant; and (3) that the new property, in its original or changed form, can be traced into the assets taken over by the Receiver at suspension. No augmentation occurs hence no trust relationship or tracing exist where the transaction results only in a shifting of bookkeeping credits on the books of the now insolvent National bank.

In the instant case the collecting bank never received by way of proceeds of the note, an identifiable res, an essential to the creation of a trust. Its assets were not augmented because the collection proceeds consisted of a check drawn against a general deposit balance already in the now insolvent National bank. Consequently, no proceeds of the transaction are traceable into the assets that passed into the hands of the Receiver.

(B) Where, as in the instant case, the record facts establish that neither trust relationship, augmentation, nor tracing of funds appear, the rights of the claimant against an insolvent National bank are in no way increased by the provisions of Sec. 350-L, subd. 2, art. 19-A of the New York Negotiable Instruments Law, which, ~~after which~~ in language, is the same as Section 13 of the Bank Collection Code and will be referred to by the latter title hereafter.

V.

ARGUMENT.

(A) Where, as in the instant case, and in the companion cases Nos. 338 and 374 set for argument immediately before and after the instant case, a claimant seeks to recover from the Receiver of an insolvent National bank money alleged to have been held by the bank on a trust, he must affirmatively establish under the unmistakable trend and weight of Federal decisions, (1) that his transaction with the bank has resulted in a trust relationship; (2) that the assets of the bank have been augmented or increased by new cash or property accruing from the claimant; and (3) that the new property, in its original or changed form, can be traced into the assets taken over by the Receiver at suspension. No augmentation occurs hence no trust relationship or tracing exist where the transaction results only in a shifting of bookkeeping credits on the books of the now insolvent National bank.

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The mandate of the National Bank Act requires a pro rata distribution of the assets of an insolvent National bank among all creditors. This mandate can be avoided by the respondent only upon affirmative proof of trust relationship, augmentation, and tracing of funds to the Receiver.

Section 5236 U. S. R. S. (12 U. S. C. Ch. 2, Sec. 194) (Appendix p. 33) requires a pro rata distribution of an insolvent National bank's assets among all its creditors. In referring to this section this court said in Cook County National Bank v. United States, 107 U. S. 445, 450, that it

> "*provides for the distribution of the entire assets of the bank*, giving no preference to any claim except for moneys to reimburse the United States for advances in redeeming the notes. When this reimbursement is fully provided for, the balance of the assets, as the proceeds are received, is subject to a ratable dividend on all claims proved to the satisfaction of the receiver, or adjudicated by a court of competent jurisdiction."

Even the United States as a sovereign is a general creditor only, unless it has taken the security provided by law, except for advances to redeem circulating notes and in minor instances involving certified checks given for customs duties and certain taxes. (19 U. S. C. Ch. 3, sec. 198; 26 U. S. C. Ch. 3, sec. 109). The circulating notes are required to be adequately secured at all times and the debtor continues to be primarily liable for the taxes and duties and consequently the exceptions are very rarely applicable.

The petitioner and all others similarly situated can avoid participation in the pro rata distribution provided by the National Bank Act only upon a showing that the assets that passed into the hands of the Receiver for the benefit of all creditors included the property of the claimant or its proceeds. The petitioner must show, *by the burden of proof*, that as a result of its transaction the bank, before suspension (a) received property of the claimant in trust, (b) that the property so received actually augmented the existing assets of the bank by way of adding thereto cash or other property (as distinguished from the addition of a bookkeeping credit) and (c) that the augmented assets, in their original or changed form passed into the hands of the Receiver.

Unless the record contains affirmative proof by the petitioner of trust relationship, augmentation and tracing of funds to the Receiver the trust claim fails because all doubts must be resolved in favor of the bank Receiver who is the trustee for general creditors. As stated by this court

in Texas & Pacific Railway v. Pottorff, 291 U. S. 245, 261, note 19, decided at the last term:

> "The claimant has the burden of identifying the property in its original or altered form. Schuyler v. Littlefield, 232 U. S. 707. It is not enough to show that at the time of receipt the general assets of the insolvent were increased or that debts were discharged. Wuerpel v. Trust Co., 238 Fed. 269, 272-3; Knauth v. Knight, 255 Fed. 677; State Bank of Winfield v. Alva Security Bank, 232 Fed. 847; In re See, 209 Fed. 172; In re Dorr, 196 Fed. 292; City Bank v. Blackmore, 75 Fed. 771; compare Railway v. Spiller, 274 U. S. 304, 311; Cunningham v. Brown, 265 U. S. 1."

In its opinion in Schuyler v. Littlefield, 232 U. S. 707, this court said, at page 713:

> "All these claims were disallowed because of the failure to make the requisite proof. Our investigation of the facts leads us to the same conclusion so far as concerns the appellants' claim. They were practically asserting title to $9,600 said to have been traced into stock in the possession of the Trustee. Like all other persons similarly situated, they were under the burden of proving their title. If they were unable to carry the burden of identifying the fund as representing the proceeds of their Interborough stock their claim must fail. If their evidence left the matter of identification in doubt the doubt must be resolved in favor of the trustee, who represents all of the creditors of Brown & Co., some of whom appear to have suffered in the same way. Like them, the appellants must be remitted to the general fund."

The following excerpt from the opinion of the Circuit Court of Appeals, Eighth Circuit in Larabee Flour Mills v. First National Bank, 13 Fed. (2nd) 330, certiorari denied 273 U. S. 727, involving facts similar to those presented in the instant case, summarizes the principles of law applicable to these claims:

"The real issue in each case is between the preference claimant and general creditors of the bank. They will get less if the preference is allowed. Each claimant asserted an equity, that the assets taken over by the Comptroller are trust funds in which it is a preferred beneficiary. It is difficult to explain or understand by what equitable right one who has not contributed to the creation of a fund should be given a special and superior interest therein, though some of the state courts seem to so hold. The collecting banks acted as agents, Commercial Bank v. Armstrong, 148 U. S. 50, 13 S. Ct. 533, 37 L. Ed. 363, *and had they collected and retained the funds called for by the drafts, as was their duty on account of insolvency, the equities of claimants would be plain; but instead of doing so they merely shifted credits on their books and records. No part of the funds in the banks when they failed was placed there by claimants or by any one for them. In each case the draft was paid by check on the insolvent. No additional funds were brought into the bank by either transaction.* If the drafts which they held for collection had been paid in currency or by check on some other bank, the insolvents' assets would have been increased that much when thereafter their remittance drafts were dishonored; and in that event equity would have regarded the collections as trust funds, followed them into the increased assets and, to the extent of the increase applied them first in discharge of these claims. *This is our conception of the rule and the reason for it, applied in the federal courts.* It has been repeatedly announced by this court. In the course of the opinion of this court in Beard v. Independent Dist. of Pella City, 88 Fed. 375, 31 C. C. A. 562, which presented the same issue we have here, on like controlling facts, it is said:

'Unless it appears that the fund or estate coming into possession of the receiver has been augmented or benefited by the wrongful use of the trust fund, no reason exists for giving the owner of the trust fund a preference over the general creditors, * * * and to assume (the position) of the owner of a trust fund, and as such to assert a preferential right to payment

> in full out of the cash fund coming into the hands of the receiver, to the detriment of the general creditors, it (claimant) ought to be held to satisfactory proof of the fact upon which the right to a preference rests, to wit, that the fund coming into the receiver's hands has been augmented and increased by the addition thereto of the trust money, *not as a matter of inference*, nor as a result of mere entries on books of account, *but because the fund or property against which the preference is sought to be enforced has been in fact augmented or benefited by the addition thereto of the trust fund.'*
>
> *The rule was reannounced by this court* in Empire State Surety Co. v. Carroll County, 194 F. 593, 606, 114 C. C. A. 435, and again in *Mechanics & Metals National Bank v. Buchanan*, 12 F. (2nd) 891, opinion filed April 28, 1926. *The Fifth Circuit announced the same principle in Anheuser Busch Brewing Ass'n. v. Clayton*, 56 F. 759, 6 C. C. A. 108; *the Sixth Circuit in City Bank of Hopkinsville v. Blackmore*, 75 F. 771, 21 C. C. A. 514; *and the Second Circuit in American Can Co. v. Williams*, 178 F. 420, 101 C. C. A. 634. See also *Boone County National Bank v. Latimer* (C. C.) 67 Fed. 27; Nyssa-Arcadia Drainage Dist. v. First National Bank of Vale (D. C.), 3 F. (2nd) 648." (Italics inserted.)

In the instant case the petitioner can establish a general claim only, because the original relationship of principal and agent, admittedly existing between the parties, never became that of trustee and cestui que trust. The collecting bank received nothing as a result of the collection of the respondent's item except a check drawn on itself. This check resulted in a mere transfer of bookkeeping credits which did not create a res, an essential to a trust. A trust cannot exist unless there is a res, *i. e.*, property to which the trust pertains. (American Law Institute, Trusts Restatement, Section 70.) A debt owing by the collecting bank to either its depositor or the forwarder of the collection item cannot become a trust res because "An obligor

cannot be trustee either of his duties or of the obligee's rights under the obligation." (American Law Institute, Trusts Restatement, Section 75, and comment "a" and illustration thereto.) As stated by this court in Blakey v. Brinson, 286 U. S. 254, 263, in discussing similar transfers of credit:

> "The cancellation of the credit balance by the debit neither suggests any intention to establish a trust nor points to any identifiable thing which could be the subject of it."

In a recent case in the Circuit Court of Appeals, Eighth Circuit, that of Hirning v. Federal Reserve Bank, 52 Fed. (2nd) 382, the basic facts were similar to those presented in the instant case. The now insolvent National bank received an item for collection and remittance and as the collection proceeds received a check drawn on itself. The court said in its opinion, page 386:

> "It is contended by the appellee that the checks sent by the Reserve Bank to the Brookings Bank constituted a trust fund, and that this trust fund has been traced into the currency and collection items sent by the Brookings Bank to the Reserve Bank.
>
> The trial court seems to have adopted this view as one of the grounds of its decision in ordering judgment for defendant.
>
> We do not agree with this contention. It must be remembered that the checks sent to the Brookings Bank by the Reserve Bank were all of them checks drawn on the Brookings Bank. *When the Brookings Bank accepted the checks, this produced no additional funds in its hands. Its assets were not augmented. No trust fund was created. If there was no trust fund, there could, of course, be no tracing of the trust fund into any assets of the Brookings Bank.* The doctrine that a trust fund is created when checks drawn on bank A by bank B for collection, i. e., for payment, has been disapproved by the decisions in this Circuit, as has also the doctrine that the forwarding bank or its principal

has a general lien on the assets of the drawee bank for the payment of such checks. Rorebeck v. Benedict, etc. Co., 26 Fed. (2nd) 440; Farmers National Bank v. Pribble, 15 Fed. (2nd) 175; Larabee Flour Mills v. First Nat. Bank, 13 Fed. (2nd) 330; Macy v. Roedenbeck, 227 Fed. 346, 352; Beard v. Independent Dist., 88 Fed. 375." (Italics inserted.)

To the same effect are the following excerpts from opinions of the Circuit Courts of Appeal for the Fourth, Fifth and Seventh Circuits.

Allied Mills, Inc. v. Horton, (C. C. A. 7) 65 Fed. (2nd) 708:

> *"It is a rule of general application in federal courts that where checks on the collecting bank are deposited in the same bank to meet a draft which the bank holds for collection, no trust in the funds thus deposited arises in favor of the drawer of the draft.* Hirning v. Federal Reserve Bank (C. C. A. 8) 52 Fed. (2nd) 382, 82 A. L. R. 297 change position of C. C. A. 8 to conform to other citations; Larabee Flour Mills v. First Nat. Bank of Dublin et al., 52 Fed. (2nd) 146 (D. C.); Larabee Flour Mills v. First National Bank of Henryetta, Okla., 13 Fed. (2nd) 330 (C. C. A. 8); Empire State Surety Co. v. Carroll County et al., 194 F. 593 (C. C. A. 8). The reason generally assigned in the cases is that in such transactions there is no augmentation of the assets of the bank. There is merely a transfer of existing assets of the bank from one to another." (Italics inserted)

Anheuser-Busch Brewing Ass'n. v. Clayton, (C. C. A. 5) 56 Fed. 759-60:

> *"The relation between appellant and the McNab Bank as to the draft on Morris sent by the former to the latter for collection was that of principal and agent; but, in order to enforce a trust in favor of appellant as to any money collected on said draft, it must be specifically traceable into the hands of the receiver.* Commercial Nat. Bank v. Armstrong, 39 Fed. Rep. 684;

> same case in Supreme Court of the United States (Oct. term, 1892; not yet officially reported, 13 Sup. Ct. Rep. 533). *Accepting Morris' check in payment of his debt to appellant, and charging the amount of it on Morris' account by the bank, was but a shifting of its liability, whereby it became appellant's debtor, and assumed the obligation to pay to it the amount of the check less exchange.* There is nothing to indicate that this amount was separated and kept unmingled with the bank's own money; but, on the contrary, it is conceded that it is undistinguishable from the mass of the bank's own money, and cannot be traced to and identified in the hands of the receiver. This being so, appellant has no better equity than the other creditors of the bank, and is entitled to no priority over them. It can only come in as a general creditor, * * *." (Italics inserted)

Ellerbe v. Studebaker Corp. (C. C. A. 4) 21 Fed. (2nd) 993:

> "In ordinary cases, of course, the receipt by the collecting bank of a check drawn against the account of one of its depositors does not bring anything into the bank, and cannot be said to augment in any way assets passing into the hands of the Receiver. It is a mere shifting of credits. Larabee Mills v. First Nat. Bank (C. C. A. 8th) 13 Fed. (2nd) 330; American Can Co. v. Williams (C. C. A. 2) 178 Fed. 420; North Carolina Corp. Com. v. Merchants & Farmers Bank, 137 N. C. 697, 50 S. E. 308."

A claim for a trust status against the assets of an insolvent National bank, based upon a transfer of bookkeeping credits was classified as general only by the Circuit Court of Appeals for the Fifth Circuit in its recent decision in First National Bank of St. Petersburg v. City of Miami, 69 Fed. (2nd) 346. The court said in its opinion (p. 346-347):

> "We agree with appellant that the case proven is not the case alleged, that as proven no case of trust was made out, and that the decree must be reversed. As alleged the draft 'was presented to the St. Peters-

> burg bank for payment and was paid,' as proven there was no payment. The draft was indeed marked paid, but *the payment thus evidenced was not in fact the payment of moneys or of any identified or identifiable thing. It was merely a form of bookkeeping; 'it was but a shifting of its liability' from the drawer to the forwarding bank.* Anheuser-Busch v. Clayton (C. C. A.) 56 F. 759, 760. As alleged 'said sum of $5000 thus collected and held for it by the St. Petersburg Bank is still in the possession of the bank and its receiver.' *As proven, no sum whatever was collected and held for plaintiff by the St. Petersburg bank to which a trust could attach. In this state of the proof to hold the bank as trustee would be to hold it a trustee not of a thing, but of a claim against itself, a holding on its face so artificial and unreal as to be impossible.*" (Italics inserted)

These excerpts are representative of many Federal decisions denying trust claimants a priority status under facts substantially the same as those presented in the instant case. No final Federal decisions to the contrary are cited by the petitioner although it does cite Federal decisions which were later reversed, as discussed hereafter.

The petitioner argues that the result of the collection transaction was the same as if the maker of the note had withdrawn the cash and paid it back over the counter in payment of the note. This is not a novel contention but one that has been rejected repeatedly by courts of equity. We know that the note obligor did not withdraw cash and redeliver it to the bank and fiction will not be resorted to to pay the petitioner from the assets that belong to depositors. To quote from the summary of an article by Mr. Justice Stone entitled "Legal Problems in the Transmission of Funds", Columbia Law Review, June 1921, page 525:

> "The very essence of the right of priority over other creditors depends upon the setting apart of a particular fund for the benefit of the depositor. There is no basis for giving one depositor a priority over another unless this is an essential part of the transaction. It

is, of course, important that bankers should be held to a high standard of accountability to their customers. It would seem, however, that this should be accomplished by appropriate legislation which should inure to the benefit of depositors generally rather than by the adoption of a rule of law creating special rights in favor of a limited class of customers on the theory that they are the beneficiaries of a quasi-trust fund which never in fact exists or is intended to exist as such."

On page 518 of the article Mr. Justice Stone says:

"The doctrine that money deposited with a bank for a special purpose is a fiduciary deposit, has been carried to extreme lengths in this country in those cases where no specific money was ever paid to the bank, the customer merely giving or procuring a credit in account in favor of the bank upon the banker's undertaking to effect payment at a distant point. Here there is no specific deposit. *The transaction results only in a credit appearing on the books of the bank, there being at no point of time any specific money or other res paid to or set apart or held by the bank for account of the customer. Even if there were an executory undertaking of the bank to become a fiduciary by setting apart such specific sum, such a relationship is not established until there is some actual setting apart or segregation of the money or some other res as the subject matter of the fiduciary relationship.*" (Italics inserted)

In the case of Schumacher v. Brinson, 52 Fed. (2nd) 821, the Circuit Court of Appeals for the Fourth Circuit resorted to a fiction similar to that urged by the Petitioner, but its decision allowing a trust claim was unanimously reversed by this court as Blakey v. Brinson, 286 U. S. 254, this court stating, pages 262, 263:

"The court below thought that the legal consequence to be attributed to the debiting of the account with the supposed purchase price of the bonds was the same as if the respondent had cashed a check for the amount and had then proceeded to hand the money back to the bank under a specific agreement between him and the

bank that the money was to be held as a special fund, for the sole purpose of completing the purchase. This view is not without support. (Citing authorities.) Such a procedure, if actually carried out, might afford a basis which is lacking here, for the inference that respondent, no longer content with the role of creditor, had sought to establish a trust fund. *But the mere debiting of his account, without more, for the reimbursement of the bank for the obligation which it was supposed to have incurred or paid, lends no support to such an inference. The cancellation of the credit balance by the debit neither suggests any intention to establish a trust nor points to any identifiable thing which could be the subject of it.*"

The following excerpts indicate similar action by other appellate courts. Smith v. Zemurray (C. C. A. 5), 69 Fed. (2nd) 5, 6.

"*To the appellee's 'as if' argument, 'the matter is to be treated as though Robinson had presented the check to the teller and on receiving the money had paid it back over the counter to buy a draft,'* American National Bank v. Miller, 229 U. S. 520, 33 S. Ct. 883, 57 L. Ed. 1310, *the receiver replies: 'Not so. We know from Robinson's own testimony that this did not occur.* We know from it that what did occur was an exchange of the paper of a bank, hopelessly insolvent, if plaintiff is right, in the form of an accepted draft on it, for paper of the same bank in the form of its draft on New York. This and nothing more.' He argues, too, that *when what actually occurred is known, it is idle to speculate on what might have been the legal effect of an entirely different occurrence.* Blakey v. Brinson, 286 U. S. 254, 52 S. Ct. 516, 76 L. Ed. 1089, 82 A. L. R. 1288."

Wisdom v. Keen (C. C. A. 5), 69 Fed. (2nd), 349, 350:

"This, then, is a case in which the bank and its customer definitely agreed that $1200.00 in cash should be held by the bank in escrow, to be delivered (not paid) on a condition and checks were given to the bank on

which it was to get the cash out of its own vault. The obligation was perfect to segregate and hold the cash. *Equity if dealing with the bank alone might well consider that it had done what it should have done and might well hold it to the consequences.* American National Bank v. Miller, 229 U. S. 517, 33 S. Ct. 883, 57 L. Ed. 1310. *But in dealing with the distribution of the assets of an insolvent national bank and with the requirement of ratable dividends to all claimants a more stringent adherence to what was actually done is proper.* Here the bank agreed to segregate a trust res but never did it. By their mutual intent the bank's relation to Keen was that of a trustee rather than a debtor, but there is still no identifiable trust res traceable as such, but only a liability for a breach of trust in failing to create the res. This liability, absent a statutory priority or lien, has no higher dignity than other general liabilities. As to every general creditor the bank has failed to do what it ought to have done and what it promised to do. The federal statute puts all such claimants on an equality. Even claims due the United States have no preference. Cook County National Bank v. United States, 107 U. S. 445, 2 S. Ct. 561, 27 L. Ed. 537." (Italics inserted)

Hecker-Jones-Jewell Milling Co. v. Cosmopolitan Trust Co. (Supreme Judicial Court of Massachusetts) (De Courcy, J.) 136 N. E. 333-335:

"The other theory is that the transaction by which the draft was paid was in legal effect the same as if B. Greenglass & Son had drawn from their account through the paying teller the sum of $3518.00, in money, and then handed it back to the collecting teller in payment of the draft. *But that is not what the debtor did; and the difference is essential, not a mere matter of form.* The payment made to the bank was not cash, to which the moment before it had not the slightest claim, and which therefore would count as wholly separate 'proceeds' of the collection; it was merely the lessening of one of its own debts, and productive of nothing even remotely suggesting a 'res' for a trust. *The difference between the legal significance*

of the actual and the assumed courses of action cannot be ignored or confused." (Italics inserted)

People v. Merchants & Mechanics Bank, 78 N. Y. 269:

"The learned counsel contends that the Troy Bank was agent of the Chemical Bank to receive payment of the check. *Suppose it were, what did it receive as such payment? Simply its own obligation.* If anything was set apart by charging up the check, it was only so much of the bank's indebtedness to its depositor. * * * To make this case analogous it would be necessary to show that the Troy Bank had separated from its general assets, and placed in the hands of some depositary a sum sufficient to pay the check, for the express purpose of being so applied, and that this fund had come to the hands of the receiver in some form. There is no approach in this case to any such state of facts."

The only Federal decision we find wherein a fiction was resorted to in allowing a trust claim against the Receiver of an insolvent National bank is that of Schumacher v. Harriett, 52 Fed. (2nd) 817, relied on by the respondent. The error of this decision, as we view it, is discussed in detail in the petitioner's brief in the companion case of Adams v. Champion, No. 338, this term. The arguments against the soundness of the Harriett decision are summarized in the recent opinions of the Circuit Court of Appeals for the Fifth Circuit as follows:

Pottorff v. Key, 67 Fed. (2nd) 833:

"Schumacher v. Harriett (C. C. A.) 52 Fed. (2nd) 817, 82 A. L. R. 1, is much relied on to sustain the judgment appealed from. The court there reviews the cases and concedes that they establish such principles as we have just asserted, but avoids their consequences *by the novel view* that a trust check, when treated by a bank as one of its cash items, is thereby confused with its cash as though it had been unidentifiable currency; and that, if the bank misuses the check, it thereby sets apart as a trust res an equivalent value of other cash

assets. *Such a doctrine amounts to saying that in every case of misapplied money or money's equivalent the wrongdoer's other cash and cash items stand in its place so long as he has any, establishing in effect a general lien on all such.* 'If the plaintiff's contention be well founded, and to follow misappropriated moneys it is only necessary to show that a receiver has, and that the trustee had, assets, the rule is simply that a demand for such moneys is a preferred claim aga nst any substantial estate. *To adopt this view is to do away with all the equitable principles out of which the right to follow trust funds grew.*' American Can Co. v. Williams (C. C. A.), 178 F. 420, at page 423. *We hold in this connection that, if a trust res can be followed, it must be; and that a lien by confusion can be fixed on a fund only when the confusion is actual and when the fund is shown to have really received and to still contain the trust res or its proceeds.* The judgment is reversed, with direction to disallow appellee's claim as preferred and to allow it as a general claim only." (Italics inserted)

Wisdom v. Keen, 69 Fed. (2nd) 349, 350:

"The view that when a bank becomes obligated to collect for another person checks drawn on itself and makes entries of their collection, it must in equity be considered to have done what it should have done, to wit, to have collected them in cash though afterwards commingling the customer's cash thus collected with its own, so that a traceable res is brought into being with title vested in the customer, has been adopted by a growing number of State courts and is said to be the majority view in an elaborate examination of the cases in 82 A. L. R. page 97. *It was pressed to its furthest extent in the Fourth Circuit in Schumacher v. Harriett,* 52 Fed. (2nd) 817, 82 A. L. R. 1, and *Schumacher v. Brinson,* 52 Fed. (2nd) 821. *Otherwise the Federal cases have been to the contrary.* 82 A. L. R. 101. Schumacher v. Brinson was appealed and reversed as Blakey v. Brinson, 286 U. S. 254, 52 S. Ct. 516, 76 L. Ed. 1089, 82 A. L. R. 1288. *We refused to follow Schumacher v. Harriett in Pottorff v. Key* (C. C. A.), 67 Fed. (2nd) 833. At the conclusion of the opinion in

Texas & Pacific R. Co. v. Pottorff, 54 S. Ct. 416, 78 L. Ed. , *the Supreme Court again indicates the necessity of an identifiable trust res in order to create a trust by misconduct as distinguished from a general liability in contract or tort. Whether the question be one of general* [illegible] *jurisprudence or of the application of the federal law relating to insolvent national banks, the views of the Federal courts must in such courts be controlling.*" (Italics inserted)

Of course had the collecting National Bank segregated a part of its cash or cash items and earmarked the same, the trust claim contended for could be established. The difference between segregation and non segregation is illustrated in St. Augustine Paint Company v. McNair (C. C. A. 5), 59 Fed. (2) 755, where the bank physically segregated a part of its cash to purchase the claimant's check held for collection. The court in its opinion at page 757 said:

> "The conversion of the check into cash and segregation of such cash from the bank's general assets before using the check are of vital consequence, as those facts distinguish that transaction from those in which a bank of deposit merely credited a check to the depositor's account so as to become the depositor's debtor, and thereafter used the check to pay the bank's own debts in such a manner that the proceeds were absorbed in a clearing transaction with no gain to the receiver, such as in Empire State Surety Co. v. Carroll Co. (C. C. A. 8), 194 Fed. 593," and other cases cited.

We believe that the above authorities establish that this court will not resort to the fiction urged by the petitioner to avoid the settled Federal rule which controls the petitioner's claim. *The Bank Receiver submits that in this case, as in Blake v. Brinson, 286 U. S. 254, the claim should be classified as general only, because of the failure to establish a relationship of trustee and cestui que trust so far as the proceeds of the note are concerned.*

(B) Where, as in the instant case, the record facts establish that neither trust relationship, augmentation, nor tracing of funds appear, the rights of the claimant against an insolvent National bank are in no way increased by the provisions of Sec. 350-L, subd. 2, art. 19-A of the New York Negotiable Instruments Law, which, in language, is the same as Section 13 of the Bank Collection Code and will be referred to by the latter title hereafter.

Section 13 of the Bank Collection Code (Sec. 350-L, subd. 2, Art. 19-A N. Y. Negotiable Instruments Law) *does not alter or modify in any way the Federal rule stated under (A) above.*

It has always been the position of the Comptroller of the Currency and it is the position of the bank Receiver in this case that all of the provisions of the Bank Collection Code, adopted in 18 States, are applicable to the transactions of National banks doing business in those States, except Section 13 of this Code and, as more fully hereinafter indicated, it is believed section 13 is inapplicable to insolvent National banks because it is in conflict with the pro rata distribution mandate of Congress (Sec. 194, Title 12 U. S. C.) (Appendix p. 33) and with the decisions of this court in Davis v. Elmira Savings Bank, 161 U. S. 275, 283, 284, 286; Easton v. Iowa, 188 U. S. 220, 229; and Cook County National Bank v. United States, 107 U. S. 445. "But a National bank is subject to State law unless that law interferes with the purposes of its creation, or destroys its efficiency, or is in conflict with some paramount Federal law." Lewis v. Fidelity Company, 292 U. S. 559, 566. The complete Bank Collection Code is printed in the appendix to the Petitioner's brief in case No. 338, Jennings v. U. S. F. & G. (pages 41 to 58), together with a foreword and comment, section by section by its proponents.

Section 13 (Appendix p. 33) is designated by its framers "Insolvency and Preferences." Subdivision 1 of Section 13 becomes effective "When the drawee or payor of

any other agent collecting bank shall fail or be closed for business." Subdivision 2 of Section 13 becomes effective when the "drawee or payor shall fail or close for business as above." Subdivision 3 of Section 13 becomes effective "Where an agent collecting bank other than the drawee or payor shall fail or be closed for business as above."

Under the plain language of the Section the trust provided therein does not come into being except in the event of insolvency. Accordingly the section is void as to National banks under the following excerpt from the opinion of this court in Davis v. Elmira Savings Bank, 161 U. S. 275, 283:

> "It is clear that these two statutes cover exactly the same subject matter. Both relate to insolvent banks; both ordain that the right of preference on the one side and the duty of ratable distribution on the other shall only result from insolvency; both cover the assets of such banks coming, after insolvency, into the hands of the officer or person authorized to administer them. It is equally certain that both statutes relate to the same duty on the part of the officer of the insolvent bank; the one directs the representative to make a ratable distribution; the other requires, if necessary, the application of the entire assets to payment in full, by preference and priority over all others of a particular and selected class of creditors therein named. We have, therefore, on the one hand, the statute of the United States, directing that the assets of an insolvent national bank shall be distributed by the Comptroller of the Currency in the manner therein pointed out, that is, ratably among the creditors. We have on the other hand, the statute of the State of New York giving a contrary command. To hold that the State statute is operative is to decide that it overrides the plain text of the Act of Congress. This results, not only from the fact that the two statutes, as we have said, cover the same subject-matter, and relate to the same duty, but also because there is an absolute repugnancy between their provisions, that is, between the ratable distribution, commanded by Con-

gress, and the preferential distribution directed by the law of the State of New York."

The conclusion of the court below that Section 13 of the Bank Collection Code is inapplicable to National banks is supported by the following Federal and State decisions:

In *City of Pleasantville v. Pleasantville National Bank* (unreported) the United States District Court, District of N. J. held Section 13 of the Bank Collection Code inapplicable to National banks. In his opinion (App. 35) District Judge Avis says:

"A reading of the Davis v. Elmira Savings Bank case demonstrates conclusively that the assets of a National bank at the time of insolvency are to be distributed under the acts of Congress, and that, although the transactions of a National bank are subject to state law, in all cases where not in conflict with the Federal law, the effort of a State to control the distribution amongst creditors is in direct conflict with the Federal statute. Assets must be disposed of in accordance with the National Bank Act, as construed by the Federal courts.

If a State, through its law-making power, were permitted to direct how the assets of an insolvent bank should be paid, there would be a constant conflict, and. under the provisions of State laws, preferences and priorities might dispose of all of the assets of an insolvent National bank.

It is apparent that the New Jersey statute invoked in this case is in conflict with the Federal law, and the bill of complaint in the instant case failing to show equity under the acts of Congress and the interpretation thereof by the United States courts, the motion to strike the bill will be granted, and the bill of complaint will be dismissed." (Italics inserted)

The findings of fact, conclusions of law and decree of the District Court of the United States for the District of Colorado in the case of Federal Reserve Bank of Kansas City

versus First National Bank of Delta, Colo., insolvent (unreported) (App. 45) support the decision of the court below. In the conclusions of law filed in that case the court held with reference to a statute similar to Section 13 of the Bank Collection Code:

> "'Chapter 63, Session Laws of Colorado 1925, providing for preferred payments upon the insolvency of banks, cannot be applied to prevent the ratable distribution provided for by the statutes of the United States to creditors of insolvent National banks;"

In a well considered unreported opinion in the case of Edward Allen Pierce, et al. v. Capital National Bank of Lansing (App. 51) the Circuit Court of Ingham County Michigan held Section 13 of the Bank Collection Code inapplicable to a National bank. To quote from the court's opinion:

> *"It will be noted that the statute, by its specific terms, does not contemplate that a trust shall be impressed on the assets of a bank in favor of the payee of a check unless the bank shall 'fail or close for business.'* Assuming for the moment that it was the intention of the State legislature that the statute should apply to National banks, may the clause quoted be upheld? On behalf of the defendant it is insisted that on the failure or closing of a National banking institution all matters pertaining to its liquidation are governed exclusively by Federal law. Reliance is placed on the decision of the Supreme Court of the United States in Easton v. Iowa, 188 U. S. 220, where the general conclusion was announced that the control of the business of National banks and what shall be done in the event of failure or suspension of operation is governed by Federal statute and that it is not competent for a State legislature to in any way interfere. Attention is called also to the decision of the Michigan Supreme Court in People v. Fonda, 62 Mich., 401.
>
> It seems apparent that the trust relationship, and consequent preference, as defined by the Michigan statute

on which plaintiffs rely must necessarily be involved, if at all, in the event of the liquidation of the assets of a bank. The reference to the failure or closing of a bank indicates that the legislature had such a situation in mind. The trust relationship contemplated does not come into being except in the event of failure or suspension, which must of course be followed by liquidation in some form. In the case of a National bank the acts of Congress govern and undoubtedly are exclusive of any right of control or direction by State authorities. The conclusion necessarily follows that the act of the Michigan Legislature may not be construed as applicable to National banks that have failed or suspended banking operations." (Italics inserted)

The Supreme Court of New York, Appellate Division, discusses the various sections of the Bank Collection Code in its opinion in Jones v. Board of Education, 272 N. Y. S. 5 and at page 14 makes the following comment on the section relied on by the petitioner:

"It may be that its officers were under the impression that it had a right of preference in the distribution of the assets of the Pelham National Bank by virtue of section 350-L of Chapter 589 of the Laws of 1929. If they so believed, they were in error, because there are no preferences among creditors of a National bank. Its assets must be divided ratably among its creditors. Title 12, Banks & Banking, Sec. 194 U. S. Code (12 U. S. C. A. Sec. 194); Davis v. Elmira Savings Bank, 161 U. S. 275, S. Ct. 502, 40 L. Ed. 700."

Also, the recent and as yet unreported opinion of the Circuit Court of Appeals for the Fourth Circuit in Royal Mfg. Co. vs. Spradlin, Receiver, decided Nov. 19, 1934 (Appendix p. 56) is in complete accord with the decision of the court below.

We find but one case involving a National bank that gives the petitioner any assistance,—that of Prudden & Company v. First National Bank of Secaucus, Court of Chancery of

New Jersey, 170 Atl. 860. This decision denies the claimant a right of priority under the general equitable principles urged by the petitioner herein but holds Section 13 of the Bank Collection Code applicable to a National bank. We submit that this decision is clearly contrary to the authorities herein cited. At a later date a petition in aid of execution was filed in the State Court, joining the Conservator in the action for the first time. The action was then removed to the United States District Court, District of New Jersey wherein it is now pending, and a petition to remand denied by District Judge Avis. If Judge Avis can now consider the whole case on the merits it is believed the claim will be classified as general only under his decision in City of Pleasantville v. Pleasantville National Bank, *supra*, p. 21 (App. 35).

In the comment on Section 13 of the Code the framers state: "The purpose of this section is to establish uniform rules based on the better reasoned decisions." We vigorously disagree with the conclusion that the State decisions, contrary to the Federal rule, are the better reasoned decisions on this question. In our opinion this statement is completely refuted by the excellent Federal decisions herein cited, including:

Larabee Flour Mills v. First National Bank, 13 Fed. (2nd) 330, Cert. denied 273 U. S. 727.
Hirning v. Federal Reserve Bank, 52 Fed. (2nd) 382.
First Nat. Bank vs. City of Miami, 69 Fed. (2nd) 346.
Harmer v. Rendleman, 64 Fed. (2nd) 422.

We direct special attention to the articles discussing in detail the various sections of the Bank Collection Code, by Wayne L. Townsend, Professor of Law, Western Reserve University, in the Tulane Law Review, December, 1933, February, 1934, and April, 1934. We are in complete accord with Professor Townsend's criticism of Section 13 of the Code and substantial excerpts therefrom are set out in the appendix, pages ~~33, 34.~~ 61 to 66

Even if the State Legislature had (which we deny) by the use of plain language, affixed a lien to the collecting bank's assets, prior to suspension, by the provisions of Section 13 of the Bank Collection Code the result would be the same—a general claim only, for the reason that a National bank is without power to give security for a *private* deposit. Texas & Pacific Railroad v. Pottorff, 291 U. S. 245. An attempt to secure a *private* depositor or his assignee by lien or otherwise would be absolutely void. In the instant case the collection proceeds consisted of a check drawn on the now insolvent National bank.

When the note debtor presented the check and received the note the check was necessarily presented and accepted by the bank for payment. Whether or not the drawer's account was charged is of no consequence as the bookkeeping entries, which do not fix the rights of the parties in this instance, could be made today. As a result of this transaction the *legal position of the petitioner is that of assignee of a private deposit balance.* The state statute could give no power to a National bank; consequently it would be inapplicable to such a bank. The National Bank Act empowers National banks to give security for public deposits; consequently the petitioner receives no assistance from this court's opinion in Lewis v. Fidelity & Deposit Company, 292 U. S. 559. In Royal Manufacturing Company v. Spradlin, 6 Fed. Sup. 98, the District Court allowed a priority claim against an insolvent National bank on the lien theory, the North Carolina statute involved (Sec. 218 (c)(14) N. C. Code 1927) being substantially different and much more favorable to the trust claimant's contentions than any provision of the Bank Collection Code. The proposition stated in this paragraph was urged in the bank Receiver's brief on appeal. The Circuit Court of Appeals for the Fourth Circuit in reversing the District Court and classifying the claim as general only, in its very recent and as yet unreported opinion dated November 19, 1934 (Parker, C. J.) (Appendix p. 56) said:

"It is clear, we think, that even if this proviso be construed as having relation to solvent banks as distinguished from those in liquidation, it cannot affect National banks. It has been held that these banks have no power to pledge their assets to secure a private deposit (Texas Pac. Ry. v. Pottorff, 291 U. S. 245, 253); and one of the reasons for this holding is that to permit such pledge would be inconsistent with many provisions of the National Bank Act which are designed to insure a ratable distribution of assets among creditors. *The same reasoning would forbid the creation of a lien on assets as security for funds collected. And, of course, if the creation of such a lien be beyond the powers of the bank, it could not be created by act of the State legislature; for the legislature could not provide that action on the part of the bank should give rise to a lien which the bank, by reason of the limitations imposed upon it by act of Congress, was powerless to create.*" (Italics inserted)

In the instant case as well as in the North Carolina case the trust claimant places much reliance on the opinion of this court in Lewis v. Fidelity & Deposit Company, *supra*. But as Judge Parker states in his opinion in Royal Manufacturing Company v. Spradlin:

"*The case of Lewis v. Fidelity & Deposit Co.*, 292 U. S. 559, *relied upon by appellee, is in reality an authority against its position.* In that case a statute of Georgia, creating a general lien on the assets of banks as security for deposits of state funds, was held to have application to a National bank merely because the act of Congress of June 25, 1930, c. 604, 46 Stat. 809, 12 U. S. C. A. 90, authorized a National bank to give security for a deposit of public funds of the same kind as authorized by State law for State banking institutions. *The Supreme Court said that no lien under the Georgia statute arose in 1928 when the deposit was made, and that the judgment of the court below sustaining the lien would have been reversed but for the enactment by Congress of the act of 1930. See p. 564. Here there is no act of Congress authorizing the creation of a lien on*

the assets of a national bank as security for collections; and the act of the North Carolina legislature can no more create a lien on the assets of a National bank than could the Georgia statute without the aid of the Act of 1930." (Italics inserted)

To avoid the classification as general only, given its claim by the principles discussed under (A) and (B) above, the petitioner relies on two theories which can be summarized as follows:

Point 1. The decision of the court below requiring an identifiable res as a condition precedent to the creation of a trust is erroneous, and equity looking to substance rather than form will consider the transaction as though the note debtor had cashed its check, received the proceeds over the counter and redelivered the same to the bank as a special deposit for the purpose of paying the petitioner's note. To support these contentions the petitioner relies on Blakey v. Brinson, 286 U. S. 254; Davis v. McNair, 48 Fed. (2nd) 494; City of Miami v. First National Bank, 58 Fed. (2nd) 561, and Northwestern Lumber Co. v. Scandinavian American Bank, 130 Wash. 33.

Point 2. Section 13 of the Bank Collection Code affixes a lien to the collecting bank's assets prior to suspension, consequently the court below erred in finding that this section is in conflict with the Act of Congress (12 U. S. C. A. 194) and with the decision of this court in Davis v. Elmira Savings Bank, 161 U. S. 275. To support this contention the petitioner relies on Jennings v. U. S. F. & G., 4 Fed. Sup. 569, affirmed 71 Fed. (2nd) 618; Royal Manufacturing Co. v. Spradlin, 6 Fed. Sup. 98; and Lewis v. Fidelity & Deposit Company, 292 U. S. 559.

The respondent admits that the law concerning the establishment of trust claims against Receivers of insolvent National banks is correctly stated in the final decisions of all the Federal cases cited in the petitioner's brief, except Schumacher v. Harriett, 58 Fed. (2nd) 817, inapplicable to

the instant case, and fully discussed in the petitioner's brief in Adams v. Champion, No. 374, set for argument immediately after this case. The respondent denies that the final decisions in any of the Federal cases cited, except Schumacher v. Harriett, give the petitioner any assistance in establishing the trust claim involved in this case.

Replying to Point I above, the necessity for a res as a condition precedent to a trust is conclusively established in the Federal courts by the decision of this court in Blakey v. Brinson, *supra*, plus the decisions discussed in this brief, pages 7 to 12. We know that in the instant case the note debtor did not cash its check and redeliver the cash to the bank in payment of the note. That Federal Equity Courts will not resort to fiction where to do so would adversely affect the rights of depositors of an insolvent National bank whose equities are at least equal to those of the petitioner seems settled by the decisions discussed in this brief, pages 13 to 16. In Blakey v. Brinson, *supra*, relied on by the petitioner, this court was asked to resort to substantially the same fiction as that urged by the petitioner. The unanimous reversal of the Appellate Court's decision, which decision was based on the "as if" doctrine, is a complete answer to the petitioner's suggestion that this court in Blakey v. Brinson, "passively approved" the "as if" doctrine. The decision of the Circuit Court of Appeals for the Fifth Circuit in Davis v. McNair, 48 Fed. (2nd) 494, relied on by the petitioner, was reversed in principle in 68 Fed. (2nd) 935, the trust claim finally allowed being based on a res traceable, in changed form, into the hands of the bank Receiver. Likewise the decision of the Circuit Court of Appeals for the Fifth Circuit in City of Miami v. First National Bank, 58 Fed. (2nd) 561, relied on by the petitioner, was reversed in an excellent later opinion reported in 69 Fed. (2nd) 346. In reversing this decision the Circuit Court of Appeals was fully aware of the action of this court in Blakey v. Brinson, *supra*, because thereafter the case was twice certified to this court and argued on one occasion

before the opinion in 69 Fed. (2nd) was written. The State decision in Northwestern Lumber Company v. Scandinavian American Bank, relied on by the petitioner, and all similar State decisions are contrary to the Federal rule as held in Larabee Flour Mills v. First National Bank, 13 Fed. (2nd) 330, certiorari denied 273 U. S. 727, wherein the court says on page 331: "It is difficult to explain or understand by what equitable right one who has not contributed to the creation of a fund should be given a special and superior interest therein though some of the State courts seem to so hold."

Replying to Point 2 above, the plain language of Section 13 of the Bank Collection Code evidences that it was intended to become effective only after the bank's insolvency, as discussed in this brief, pages 19 to 24. Accordingly Section 13 is void as to National banks under the rule stated by this court in Davis v. Elmira Savings Bank, *supra*. The case of Jennings v. U. S. F. & G. Co., 4 Fed. Sup. 569, affirmed 71 Fed. (2nd) 618, relied on by the petitioner, gives it no assistance because Section 13 of the Bank Collection Code was not relied on by the courts below in allowing the trust claim. Sections 1, 2, 9 and 10 of the Bank Collection Code alone are involved in that case. Furthermore the trust claim involved has not been finally allowed and is now before this court, set for argument immediately prior to the instant case. The case of Royal Manufacturing Co. v. Spradlin, 6 Fed. Sup. 98, relied on by the petitioner, was reversed and the claim classified as general only by the Circuit Court of Appeals for the Fourth Circuit on November 19, 1934. (App. 56) The decision of this court in Lewis v. Fidelity & Deposit, 292 U. S. 559, relied on by the petitioner, is in fact a case against its contentions as discussed by Circuit Judge Parker in his opinion in Royal Manufacturing Company v. Spradlin, *supra*. (App. 56)

At page 16 of its brief the petitioner states that the court below does not attempt to indicate in what respect Section 13 of the Bank Collection Code is in conflict with Section

194, Title 12, U. S. C. A. But the opinion of the court below (R. 44) states:

> "It is true that the state statute (Sec. 350-1, subd. 2, art. 19-A, Negotiable Instruments Law) expressly grants a preference under the circumstances at bar upon the insolvency of the drawee or payor bank, but state legislation is unavailing if contrary to the Act of Congress (12 U. S. C. A. Sec. 194) as construed by the Federal courts. On the authorities above mentioned and many others which might be cited, we think it is."

The petitioner asserts that the validity of the bank collection code should be upheld by this court if it is at all possible to reconcile its provisions with the Act of Congress. To this the bank Receiver answers that all provisions of the Bank Collection Code, except Section 13, are uniformly applied in the liquidation of insolvent National banks, hence the one question for consideration in this connection is whether or not Section 13 of the Code conflicts with the pro rata distribution mandate of Congress. That there is such a conflict which makes the section inapplicable to insolvent National banks is established by the two decisions of Davis v. Elmira Savings Bank, 161 U. S. 275, and Royal Manufacturing Co. v. Spradlin. (App. 56)

The National banking laws, and related acts, together with a long line of decisions by this Court clearly evidence an intent to safeguard the assets of insolvent National banks in liquidation, thus insuring a maximum distribution to the depositors and creditors. Taxes due the United States which would be paid from the funds of depositors are abated. (Sec. 570, Title 12 U. S. C. A.) The preference given the United States as a sovereign against insolvent estates generally is made inapplicable to such banks. Suits to wind up the affairs of such banks are made cognizable in the Federal courts, *independent of the amount involved.* A separate system of liquidation is provided, independent of the Bankruptcy Act. Sales and compromises of assets can be made only after court approval and advances to protect

assets can be made only upon approval by the Secretary of the Treasury. Annual reports of the results of liquidation are required to be made to Congress. While the claimants in the instant case and in the companion cases Nos. 358 and 374 assert ownership of property taken over by the Receivers they are in fact, as established by the record, seeking to be made whole from the funds of the depositors. To permit any class of claimants to be paid in full from the funds of depositors, when such funds were in no way enriched by the claimants' transaction, would flagrantly violate the principles heretofore adhered to in liquidating insolvent National banks.

The depositors and other creditors of this insolvent National bank—the beneficial owners of all its assets—will suffer a very substantial loss because of their dealings with the bank. The equities of these depositors and other creditors are at least equal to those of the petitioner. The record establishes that no part of the assets that passed to the Receiver came into the bank as a result of the petitioner's transaction. All of the assets that passed to the Receiver came into the bank as the result of transactions other than the petitioner's. None of the assets of the bank were segregated to respond for the petitioner's claim under the provisions of the Bank Collection Code and no segregation was intended by that statute. Under these circumstances the court below correctly found for the bank Receiver when it classified the petitioner's claim as general only.

CONCLUSION.

The respondent believes that the foregoing discussion establishes that a trust never came into existence in the instant case; that the assets of this now insolvent National bank were not augmented in any way by the collection of the petitioner's item; that a tracing of proceeds into the assets acquired by the bank Receiver is impossible and that the rights of the petitioner against the bank Receiver are

in no way increased by the provisions of Section 13 of the Bank Collection Code. A reversal of the decision of the court below may be construed to mean the overruling of the great body of Federal decisions requiring the existence of a trust res and the tracing of proceeds to the Receiver or a holding that a State statute in conflict with the National Bank Act can be made applicable to the liquidation of an insolvent National bank.

It is submitted that the decision of the court below should be affirmed.

Respectfully submitted,

JOHN F. ANDERSON,
HUMPHREY J. LYNCH,
Attorneys for Respondent.

F. G. AWALT,
GEORGE P. BARSE,
Attorneys for Comptroller of the Currency,
Of Counsel.

APPENDIX.

U. S. C. A. Title 12, Sec. 194.

DIVIDENDS ON ADJUSTED CLAIM; DISTRIBUTION OF ASSETS. From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the Comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held. (R. S. Sec. 5236)

Section 13, Bank Collection Code (Negotiable Instruments Law of New York, section 350-1, subd. 2, art. 19-A)

INSOLVENCY AND PREFERENCES. 1. When the drawee or payor, or any other agent collecting bank shall fail or be closed for business by (official to be designated) or by action of the board of directors or by other proper legal action, after an item shall be mailed or otherwise entrusted to it for collection or payment but before the actual collection or payment thereof, it shall be the duty of the receiver or other official in charge of its assets to return such item, if same is in his possession, to the forwarding or presenting bank with reasonable diligence.

2. Except in cases where an item or items is treated as dishonored by non-payment as provided in Section 11, when a drawee or payor bank has presented to it for payment an item or items drawn upon or payable by or at such bank and at the time has on deposit to the credit of the maker or drawer an amount equal to

such item or items and such drawee or payor shall fail or close for business as above, after having charged such item or items to the account of the maker or drawer thereof or otherwise discharged his liability thereon but without such item or items having been paid or settled for by the drawee or payor either in money or by an unconditional credit given on its books or on the books of any other bank, which has been requested or accepted so as to constitute such drawee or payor or other bank debtor therefor, the assets of such drawee or payor shall be impressed with a trust in favor of the owner or owners of such item or items for the amount thereof, or for the balance payable upon a number of items which have been exchanged, and such owner or owners shall be entitled to a preferred claim upon such assets, irrespective of whether the fund representing such item or items can be traced and identified as part of such assets or has been intermingled with or converted into other assets of such failed bank.

3. Where an agent collecting bank other than the drawee or payor shall fail or be closed for business as above, after having received in any form the proceeds of an item or items entrusted to it for collection, but without such item or items having been paid or remitted for by it either in money or by an unconditional credit given on its books or on the books of any other bank which has been requested or accepted so as to constitute such failed collecting or other bank debtor therefor, the assets of such agent collecting bank which has failed or been closed for business as above shall be impressed with a trust in favor of the owner or owners of such item or items for the amount of such proceeds and such owner or owners shall be entitled to a preferred claim upon such assets, irrespective of whether the fund representing such item or items can be traced and identified as part of such assets or has been intermingled with or converted into other assets of such failed bank.

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

Between THE CITY OF PLEASANTVILLE, a municipal corporation of the County of Atlantic and State of New Jersey, *Complainant*, And THE PLEASANTVILLE NATIONAL BANK by ALONZO TWEEDALE, Receiver, *Defendant*.	IN EQUITY E-4780 On Bill, etc. On Motion to strike bill of complaint.

G. ARTHUR BOLTE, For the Motion

L. D. CHAMPION, Opposed

MEMORANDUM

AVIS, *District Judge:*

This action was originally instituted in the Court of Chancery of New Jersey, and has been removed to this court on application of defendant.

The facts, generally, as alleged in the bill of complaint are: Complainant, a municipal corporation of the State of New Jersey, on February 2, 1933, deposited for collection with the First National Bank of Pleasantville, New Jersey (hereinafter called First National Bank) a certain check, drawn to its order, for the sum of $3212.94. Marvin R. Martin, Custodian of School Funds of the City of Pleasantville, was the drawer of the check, and it was made payable at the Pleasantville National Bank of Pleasantville, New Jersey (hereinafter called Pleasantville Bank). Both of these banks were located in the same city, and it was the custom of the banks to clear between themselves on each banking day. Items for collection were forwarded from one bank to the other, and at the end of the day's business the debtor bank, in some way, paid to the creditor bank, the balance due.

The check of complainant was, with other items for collection, forwarded by the First National Bank to Pleasantville Bank, and, upon settlement of the accounts, it appeared that First National Bank's credit was $3505.07, and Pleasantville Bank's credit was $777.16, leaving a balance due to First National Bank of $2727.91. For this amount the Pleasantville Bank forwarded to First National Bank its draft on the Federal Reserve Bank of Philadelphia. Before the amount of this draft was credited to First National Bank, the Pleasantville Bank became insolvent and a receiver was appointed by the Comptroller of the Currency. The draft was never paid.

When the check of complainant was received at Pleasantville Bank, upon which it was drawn, it was marked paid and charged to the account of the drawer.

Complainant's bill alleges that, under the circumstances, it has a right to have a trust impressed on the assets of the Pleasantville Bank to the extent of $2495.34, being its proportionate share of the balance transmitted by draft to First National Bank upon the settlement of the daily transactions between the two banks, and prays for a decree to that effect.

Defendant has moved to strike the bill of complaint, claiming that the facts set forth therein are not legally sufficient to entitle the complainant to relief.

Counsel for the motion argues—

(1) That the facts alleged do not create a trust.

(2) That the funds in the hands of the receiver were not and are not augmented by any claimed trust.

(3) That no funds arising from the transaction were traced into the hands of the receiver.

Counsel for complainant opposes these contentions, and also sets up a statute of the State of New Jersey (known as the Bank Collection Code) which, he insists, is controlling. This statute reads as follows:

> "(2) Except in cases where an item or items is treated as dishonored by non-payment as provided in

section 11, when a drawee or payor bank has presented to it for payment an item or items drawn upon or payable by or at such bank and at the time has on deposit to the credit of the maker or drawer an amount equal to such item or items and such drawee or payor shall fail or close for business as above, after having charged such item or items to the account of the maker or drawer thereof or otherwise discharge his liability thereon but without such item or items having been paid or settled for by the drawee or payor either in money or by an unconditional credit given on its books or on the books of any other bank, which has been requested or accepted so as to constitute such drawee or payor or other bank debtor therefor, the assets of such drawee or payor shall be impressed with a trust in favor of the owner or owners of such item or items for the amount thereof, or for the balance payable upon a number of items which have been exchanged, and such owner or owners shall be entitled to a preferred claim upon such assets, irrespective of whether the fund representing such item or items can be traced and identified as part of such assets or has been intermingled with or converted into other assets of such failed banks."

(Supplement to Comp. State of New Jersey 1925-1930, Sec. 13, p. 94.)

Two principles of law are involved: The general theory of the Federal courts as to the creation of a trust and preference against the assets of an insolvent national bank, and the applicability and effect of the New Jersey statute.

To establish a preference against the funds of an insolvent bank, it must appear that there was some agreement of trust, express or implied; that the assets of the bank coming to the receiver were augmented, and the funds traced into some particular property or money turned over to the receiver.

Complainant claims that a trust was implied by reason of the fact that the amount of the check was charged to the account of the drawer, and that on the date of such charge

and the execution and delivery of the draft, and up to the hour of insolvency, the Pleasantville Bank had in its possession sufficient funds to pay and satisfy the amount due to complainant.

There is considerable confusion in the various Federal and State courts on the question here at issue, and each case appears to be decided upon the particular facts involved.

The question as to the liability of an agent collection bank is not raised in the instant suit, as was decided in the case of *Federal Reserve Bank of Richmond v. Malloy*, 264 U. S. 160, nor is the liability of a Federal Reserve Bank claimed, as decided in *Early, Receiver, v. Federal Reserve Bank of Richmond*, 281 U. S. 84.

The bill alleges that the check was deposited "for collection", and, therefore, the question of the relation of creditor and debtor does not arise, as decided in *City of Douglas v. Federal Reserve Bank of Dallas*, 271 U. S. 489 and in *Equitable Trust Company, Trustee, v. Rochling*, 275 U. S. 248.

I am satisfied that, under the Federal Decisions, no trust was created, unless the complainant's bill sets forth facts tracing the proceeds of the collection into the hands of the receiver, or that the assets which have come into his hands have been augmented.

This doctrine is established in the case of *Lifsey v. Goodyear Tire & Rubber Co., Inc.* (C. C. A. 4), 67 F. (2d) 82. The decision in that case, with the cases cited, shows conclusively that the facts alleged in the bill of complaint in the instant case are not sufficient to create a trust. See, also, *Thompson v. Common School District No. 54, in Twin Falls County, Idaho* (C. C. A. 9), 67 Fed. (2d) 284.

It is true that in the case cited by counsel for complainant, to wit, *City of Miami v. First Nat. Bank of St. Petersburg, Fla.*, (C. C. A. 5) 58 F. (2d) 561, a contrary doctrine was established, and upon facts very similar to those in the instant case.

However, after the decision of the City of Miami case, the Supreme Court in the case of *Blakey, Receiver, v. Brinson*, 286 U. S. 254, in reversing the decision of the Fourth Circuit in the case of *Schumacher v. Brinson*, 52 Fed. (2d) 821, established the law, which is in conflict with the decision in the City of Miami case. It is apparent that the conclusions of the court in the case of Lifsey v. Goodyear Tire & Rubber Co., *supra*, follows the Supreme Court, and in effect, the case of City of Miami v. First Nat. Bank of St. Petersburg, *supra*, is thereby overruled.

The case of *Schumacher v. Harriett* (C. C. A. 4), 52 Fed. (2d) 817, is distinguishable from the instant case in that in that case certain funds were paid to the bank for a specific purpose and upon a specific trust. The funds coming into the hands of the receiver were augmented thereby, and the deposit was traced into the general assets.

In *Blakey v. Brinson*, 286 U. S. 254, the Supreme Court decided the disputed question as to whether the charging of a depositor's account with a certain amount of money and crediting that amount in a general bond account of the bank, upon an arrangement contemplating the purchasing of bonds for the depositors, would create a trust. The court held that it would not.

The Court said:

> "The court below thought that the legal consequence to be attributed to the debiting of the account with the supposed purchase price of the bonds was the same as if the respondent had cashed a check for the amount and had then proceeded to hand the money back to the bank under a specific agreement between him and the bank that the money was to be held as a special fund, for the sole purpose of completing the purchase. This view is not without support. See Davis v. McNair, 48 F. (2d) 494; State v. Grills, 35 R. I. 70, 75; 85 Atl. 281; Northwest Lumber Co. v. Scandinavian American Bank, 130 Wash. 33; 225 Pac. 825; State v. American Exchange Bank, 112 Neb. 834; 201 N. W. 895. See, Contra, Beard v. Independent District of Pella City,

88 Fed. 375, 381; Mark v. Westlin, 48 F. (2d) 609; First National Bank v. Williams, 15 F. (2d) 585; Howard v. People, 229 Ill. App. 23; Miller v. Viola State Bank, 121 Kan. 193; 246 Pac. 517; People v. Merchants & Mechanics' Bank of Troy, 78 N. Y. 269; Hecker-Jones-Jewell Milling Co. v. Cosmopolitan Trust Co., 242 Mass. 181; 136 N. E. 333. Such a procedure, if actually carried out, might afford a basis, which is lacking here, for the inference that respondent, no longer content with the role of creditor, had sought to establish a trust fund. But the mere debiting of his account, without more, for the reimbursement of the bank for the obligation which it was supposed to have incurred or paid, lends no support to such an inference. The cancellation of the credit balance by the debit neither suggests any intention to establish a trust nor points to any identifiable thing which could be the subject of it.

The debit entry may be disregarded, because respondent's assent to it was procured by a false statement; but the only consequence is that his status as a creditor is unaffected and he is entitled only to share in the funds of the bank on an equal footing with other creditors who similarly are the victims of its insolvency."

(286 U. S. 262-3)

The facts in the instant case are similar. The Pleasantville Bank charged the amount of the check to the account of Marvin R. Martin, Custodian of the School Funds, its depositor, and, in effect, credited the amount to the account of the First National Bank.

There remains to be considered the applicability and effect of the New Jersey statute.

The distribution of the funds of an insolvent national bank is provided for in 12 U. S. C. A., sec. 194, as follows:

"From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the comptroller shall make a ratable dividend of the money

so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held."

The settled policy of the Federal courts has been to consider trust funds as the property of the cestui que trust, and, if the trust is established under the law, to be payable prior to the distribution provided for in this statute.

In the case of *McClellan v. Chipman*, 164 U. S. 347, the court, as to the conflict of national and state laws relating to national banks, said:

"The only Federal question for our consideration is whether there was conflict between the statutes of the United States and the provisions of the general law of the State of Massachusetts referred to and heretofore fully set out. Two propositions have been long since settled by the decisions of this court:

First. National banks are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the nation. All their contracts are governed and construed by State laws. Their acquisition and transfer of property, their right to collect their debts and their liability to be sued for debts, are all based on the state law. It is only when the state law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional. National Bank v. Commonwealth, 9 Wall. 362.

Second. National Banks are instrumentalities of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States. It follows that an attempt by a State to define their duties, or control the conduct of their affairs, is absolutely void, whenever such attempted exercise of authority expressly conflicts with

> the laws of the United States, and either frustrates the purpose of the national legislation, or impairs the efficiencies of these agencies of the Federal government to discharge the duties for the performances of which they are created. Davis v. Elmira Savings Bank, 161 U. S. 275, 283.
>
> These two propositions, which are distinct yet harmonious, practically contain a rule and an exception, the rule being the operation of general state laws upon the dealings and contracts of national banks, the exception being the cessation of the operation of such laws whenever they expressly conflict with the laws of the United States or frustrate the purpose for which the national banks were created, or impair their efficiency to discharge the duties imposed upon them by the law of the United States."
>
> (164 U. S. 356.)

The Supreme Court in the case of *First National Bank of San Jose v. State of California*, 262 U. S. 366, held as follows:

> "A state law providing for the escheat to the State of bank deposits after they have remained intact and unclaimed for more than twenty years, when no notice of his residence has been filed with the bank by the depositor or any claimant, is void as applied to deposits in National banks."
>
> (Syllabus.)

In the case of *First National Bank in St. Louis v. State of Missouri*, 263 U. S. 640, it was held that a state statute prohibiting the establishment of branch banks was not in conflict with federal law, and sustained the state law as regulatory of national banks, because "Under the National Bank Law, power to establish branches is withheld." (Syllabus 3.)

On the general proposition the Court in that case said:

> "National banks are brought into existence under federal legislation, are instrumentalities of the Fed-

eral Government and are necessarily subject to the paramount authority of the United States. Nevertheless, national banks are subject to the laws of a State in respect to their affairs unless such laws interfere with the purposes of their creation, tend to impair or destroy their efficiency as federal agencies or conflict with the paramount law of the United States."

(263 U. S. 656)

Counsel for complainant cites the case of *Federal Reserve Bank of Richmond v. Malloy,* 264 U. S. 160, as authority for his contention that the state statutes control. In that case the court did apply the Federal statue which defined the rights of depositors and the business operation of the bank.

In all of the foregoing cases, however, no question of insolvency or distribution of assets by a receiver, was involved.

The New Jersey statute attempts to regulate the distribution of the assets of an insolvent national bank.

In the case of *Davis v. Elmira Savings Bank,* 161 U. S. 275, the court held that a statute of the State of New York provided for the payment by the receiver of an insolvent national bank, in the first place, of deposits in the bank by savings bank, when applied to an insolvent national bank, was in conflict with section 5236 of the Revised Statutes of the United States (12 U. S. C. A. sec. 194), directing the Comptroller of the Currency to make ratable dividends of the money paid over to him by such receiver, on all claims proved to his satisfaction, or adjudicated in a court of competent jurisdiction, and was, therefore, void when attempted to be applied to a national bank.

See also *Easton v. Iowa,* 188 U. S. 220, and *Yates v. Jones National Bank,* 206 U. S. 158.

A reading of the Davis v. Elmira Savings Bank case demonstrates conclusively that the assets of a national bank at the time of insolvency are to be distributed under the acts

of Congress, and that, although the transactions of a national bank are subject to state law, in all cases where not in conflict with the federal law, the effort of a State to control the distribution amongst creditors is in direct conflict with the Federal statute. Assets must be disposed of in accordance with the National Bank Act, as construed by the Federal Courts.

If a State, through its law-making power, were permitted to direct how the assets of an insolvent bank should be paid, there would be a constant conflict, and, under the provisions of state laws, preferences and priorities might dispose of all of the assets of an insolvent national bank.

It is apparent that the New Jersey statute invoked in this case is in conflict with the Federal law, and the bill of complaint in the instant case failing to show equity under the acts of Congress and the interpretation thereof by the United States courts, the motion to strike the bill will be granted, and the bill of complaint will be dismissed.

Since preparing the above memorandum, my attention has been called to the case of *The First National Bank of St. Petersburg, Florida, v. City of Miami,* decided by the United States Circuit Court of Appeals for the Fifth Circuit on March 1, 1934 (not yet officially reported).

This later decision, in effect, overrules the construction placed thereon by counsel for complainant in citing the decision of the same court in the case of City of Miami v. First National Bank of St. Petersburg, *supra,* as it applies to the facts set forth in the bill of complaint in the instant case. As a precedent and authority for contention of complainant, the decision in the earlier case is ineffective.

IN THE DISTRICT COURT OF THE UNITED STATES
FOR THE DISTRICT OF COLORADO.

FEDERAL RESERVE BANK OF KANSAS CITY, *Complainant,* *vs.* THE FIRST NATIONAL BANK OF DELTA, COLORADO, ARCH R. JACK, RECEIVER OF THE FIRST NATIONAL BANK OF DELTA, COLORADO, *Defendants.*	No. 9828 IN EQUITY.

FINDINGS OF FACTS AND CONCLUSIONS OF LAW.

This cause came on to be heard on the 9th day of June, 1932, upon the complaint, answer, agreed statement of facts and evidence offered by the complainant, the cause was duly argued by counsel, and the Court, being now fully advised in the premises, makes the following

FINDINGS OF FACTS:

1. The complainant, Federal Reserve Bank of Kansas City, is a banking corporation organized and existing under the laws of the United States, with its principal office and place of business in Kansas City, Missouri, and with a branch office at Denver, Colorado.

2. The First National Bank of Delta is a banking corporation organized and existing under and by virtue of the laws of the United States, with its place of business at Delta, Colorado.

3. That The First National Bank of Delta was declared insolvent by resolution of its Board of Directors at 8:00 o'clock P.M. on Friday, September 20, 1929, and defendant Arch R. Jack is the duly appointed, qualified and acting Receiver appointed for the purpose of liquidating the assets of said bank and winding up its affairs.

4. That on and subsequent to September 14, 1929, the Denver branch of said Federal Reserve Bank of Kansas

City forwarded by mail to said The First National Bank of Delta various checks drawn on said The First National Bank of Delta by depositors of said Delta Bank; that four of such remittances were made resulting in claims by said Federal Reserve Bank of Kansas City against The First National Bank of Delta and its Receiver, in the aggregate amount of Eighteen Thousand, Thirty-two and 9/100 ($18,-032.09) Dollars.

5. That said checks forwarded for collection and remittance to The First National Bank of Delta were received by the latter bank on September 18, 19 and 20, 1929, and were in all cases charged to the respective accounts of the drawers thereof in The First National Bank of Delta and were marked paid by the latter bank.

6. That no remittance whatever was made by The First National Bank of Delta for the checks so received on September 18 and 19, 1929, but that The First National Bank of Delta drew its two drafts against its correspondent, The First National Bank of Denver, covering the checks received on September 20, 1929, payable to the order of the Denver branch of the Federal Reserve Bank, which received such drafts on September 23, 1929, but was unable to obtain payment thereon for the reason that The First National Bank of Delta had suspended prior to the time such drafts could be presented for payment, and that payment had been stopped after the closing of said bank.

7. That the Federal Reserve Bank and its Denver branch were acting on behalf of its principals, the banks which forwarded said checks to said Federal Reserve Bank for collection as agent of such banks, under the provisions of Regulation J promulgated by the Federal Reserve Board, and under the terms of its own general letter governing its check collection operations. Said Federal Reserve Bank had authority to send said checks direct to The First National Bank of Delta for collection and to take the drafts of such bank which might be issued in remittance therefor, and said The First National Bank of Delta was required

to, and had agreed to remit for all checks accepted or collected by it received from said Federal Reserve Bank or its Denver branch in cash, or its equivalent.

8. That the claims filed by the Federal Reserve Bank with the defendant Receiver assert the right on the part of the complainant and the owners of the checks on which said claims are based to receive and obtain payment thereof prior to the payment of the claims of general creditors of The First National Bank of Delta; that while defendants deny the right of complainant to preferred claims, they admit that such claims should be allowed as common claims against The First National Bank of Delta.

9. That all of the various checks on which said claims were made by the Federal Reserve Bank were drawn by depositors of The First National Bank of Delta upon the latter bank, and the forwarding thereof by the Federal Reserve Bank and charging them to the depositors did not increase or augment in any way the assets of The First National Bank of Delta.

CONCLUSIONS OF LAW.

Whereupon, the Court concludes as a matter of law:

1. That Regulation J of the Federal Reserve Board and General Letter D-1 of the Federal Reserve Bank prescribing certain rules under which the Federal Reserve Bank collects such items as those here in evidence do not give rise to any relationship of trust or create any trust fund;

2. There was no increase or augmentation of the assets of The First National Bank of Delta by the forwarding by the Federal Reserve Bank to that bank, for collection, of checks drawn by the depositors of The First National Bank of Delta upon the latter bank, and the charging of such checks to their depositors by the latter bank, and the complainant is not entitled to have its claims, or any of them, allowed as preferred claims, or to payment prior to the general creditors of The First National Bank of Delta;

3. Chapter 63, Session Laws of Colorado 1925, providing for preferred payments upon the insolvency of banks, cannot be applied to prevent the ratable distribution provided for by the statutes of the United States to creditors of insolvent National banks;

4. Complainant is entitled to the allowance of each of said claims, in the respective amounts of Five Thousand, Two Hundred Fifty-eight and 27/100 ($5,258.27) Dollars, Six Thousand, Six Hundred Twenty and 86/100 ($6,620.86) Dollars, One Thousand, Nine Hundred Fifty-two and 84/100 ($1,952.84) Dollars and Four Thousand, Two Hundred and 12/100 ($4,200.12) Dollars as common claims against the Receiver of The First National Bank of Delta.

J. Foster Symes,
Judge.

Ex saved.

A True Copy,

Teste:

Charles W. Bishop,
Clerk.

By Elsie Pelissier,
Deputy Clerk.

(Seal)

IN THE DISTRICT COURT OF THE UNITED STATES
FOR THE DISTRICT OF COLORADO.

FEDERAL RESERVE BANK OF KANSAS CITY, *Complainant,* *vs.* THE FIRST NATIONAL BANK OF DELTA, COLORADO, ARCH R. JACK, RECEIVER OF THE FIRST NATIONAL BANK OF DELTA, COLORADO, *Defendants.*	No. 9828 IN EQUITY. DECREE

This cause came on to be heard at this term and was argued by counsel; and thereupon, upon consideration thereof, it was ORDERED, ADJUDGED AND DECREED as follows, viz:

That the complainant has failed to establish the necessary facts to enable it to have its claims allowed as preferred, but is entitled to allowance of such claims as general claims;

That complainant's claims in the sums, respectively, of Five Thousand, Two Hundred Fifty-eight and 27/100 ($5,258.27) Dollars, Six Thousand, Six Hundred Twenty and 86/100 ($6,620.86) Dollars, One Thousand, Nine Hundred Fifty-two and 84/100 ($1,952.84) Dollars, and Four Thousand, Two Hundred and 12/100 ($4,200.12) Dollars, aggregating Eighteen Thousand, Thirty-two and 9/100 ($18,032.09) Dollars, as agent, as alleged in the complaint herein, be established and allowed as common or general claims, and the Receiver of The First National Bank of Delta is ordered to allow and pay them in due course as such;

That defendants have judgment against complainant for their costs in this behalf expended to be taxed by the Clerk.

Done this 28th day of June, 1932.

J. FOSTER SYMES,
Judge.

A True Copy,

Teste:

CHARLES W. BISHOP,
Clerk.

By ELSIE PELISSIER,
Deputy Clerk.

(Seal)

STATE OF MICHIGAN

THE CIRCUIT COURT FOR THE COUNTY OF INGHAM

IN CHANCERY

EDWARD ALLAN PIERCE ET AL., *Plaintiffs*,

v.

CAPITAL NATIONAL BANK OF LANSING, a National banking Association, *Defendant*.

No. 16293

The facts in this case are not in dispute. On the 9th of February, 1933, the plaintiffs, who are copartners, received from the Motor Wheel Corporation of Lansing, Michigan, a check in the sum of approximately fifteen hundred dollars. Said check was deposited for collection with the First National Bank of Detroit, went through the Federal Reserve Bank in the usual course, and on February 11th was duly presented to the defendant, the drawee named in the check. At that time the drawer had sufficient deposits to cover the amount of the check and the defendant charged the drawer's account accordingly. On the same day a check or draft covering the amount of the check in question, together with various other items, was forwarded by defendant to Detroit, but on account of the so-called bank holiday such check or draft did not clear. Since the 11th of February the defendant bank has not been open for the carrying on of a normal banking business and has not made payment to plaintiff.

The action was originally started on the law side of the court, but was transferred in accordance with the statute permitting such action. In the bill of complaint plaintiffs seek a decree to the effect that the amount of the check is a trust fund in the hands of the defendant, asking also that defendant be required to pay to plaintiffs the amount of such check in full, with interest. Defendant denies the ex-

istence of any trust relationship and states further by the answer, which is not controverted, that on the 23rd of March, 1933, which was prior to the institution of suit, a conservator was appointed for the defendant bank by the Comptroller of the Currency in accordance with the Federal statute. As above suggested, plaintiffs' claim of a right to a preference is based on the theory of a trust relationship. Reliance is placed on subdivision 2 of section 13 of act 240 of the public acts of 1931, commonly referred to as the bank collection code. Said subdivision reads as follows:

> "Except in cases where an item or items is treated as dishonored by non-payment as provided in section eleven, when a drawee or payor bank has presented to it for payment an item or items drawn upon or payable by or at such bank and at the time has on deposit to the credit of the maker or drawer an amount equal to such item or items and such drawee or payor shall fail or close for business as above, after having charged such item or items to the account of the maker or drawer thereof or otherwise discharged his liability thereon but without such item or items having been paid or settled for by the drawee or payor either in money or by an unconditional credit given on its books or on the books of any other bank, which has been requested or accepted so as to constitute such drawee or payor or other bank debtor therefor, the assets of such drawee or payor shall be impressed with a trust in favor of the owner or owners of such item or items for the amount thereof, or for the balance payable upon a number of items which have been exchanged, and such owner or owners shall be entitled to a preferred claim upon such assets, irrespective of whether the fund representing such item or items can be traced and identified as part of such assets or has been intermingled with or converted into other assets of such failed bank."

It will be noted that the statute, by its specific terms, does not contemplate that a trust shall be impressed on the as-

sets of a bank in favor of the payee of a check unless the bank shall "fail or close for business". Assuming for the moment that it was the intention of the state legislature that the statute should apply to National banks, may the clause quoted be upheld? On behalf of the defendant it is insisted that on the failure or closing of a National banking institution all matter pertaining to its liquidation are governed exclusively by Federal law. Reliance is placed on the decision of the Supreme Court of the United States in Easton v. Iowa, 188 U. S. 220, where the general conclusion was announced that the control of the business of National banks and what shall be done in the event of failure or suspension of operation is governed by Federal statute and that it is not competent for a state legislature to in any way interfere. Attention is called also to the decision of the Michigan Supreme Court in People v. Fonda, 62 Mich. 401.

It seems apparent that the trust relationship, and consequent preference, as defined by the Michigan statute on which plaintiffs rely, must necessarily be involved, if at all, in the event of the liquidation of the assets of a bank. The reference to the failure or closing of a bank indicates that the Legislature had such a situation in mind. The trust relationship contemplated does not come into being except in the event of failure or suspension, which must of course be followed by liquidation in some form. In the case of a National bank the acts of Congress govern and undoubtedly are exclusive of any right of control or direction to state authorities. The conclusion necessarily follows that the act of the Michigan Legislature may not be construed as applicable to National banks that have failed or suspended banking operations.

Counsel for plaintiffs contend that, without reference to the provisions of the Michigan statute, they are, under general principles of law and equity, entitled to have a preference decree. Such claim rests on the theory of a trust re-

lationship arising under such circumstances as are involved in the case at bar, in favor of the payee of a check with reference to the assets of the drawee bank. Attention is called to the decision of the Circuit Court of Appeals of the Fifth Cir. in Miami v. Nat. Bank of St. Petersburg, 58 Fed. (2d) 561. The Court there applied the law of Florida as established by statute and court decisions. From an examination of the authorities, I am brought to the conclusion that the weight of authority is not in accordance with the holding in the case cited. Rather the general rule seems to be that the trust relationship required to support the allowance of a preference in the distribution of the assets of a closed bank does not arise unless such assets have been augmented as a result of the transaction involved. Blakey, Receiver, v. Brinson, 286 U. S. 254, and cases there cited. The conclusion follows that plaintiffs are not entitled to the preference sought to be enforced in this proceeding.

On the record made in the instant case, questions in addition to those above discussed are presented, but in my opinion it is unnecessary to refer to them at length. The assets on which plaintiffs seek to impress the trust are in the hands of the conservator appointed by the Comptroller of the Currency. The bill of complaint however, seeks no relief against the conservator and he is not made a party. In the law action he sought and obtained leave to intervene but it does not appear that he has acted thereunder. The answer to the bill has been filed by the bank alone.

Decree will enter denying the relief sought.

LELAND W. CARR,
Circuit Judge.

State of Michigan, County of Ingham, ss:

I, C. Ross Hilliard, Clerk of the Circuit Court for the County of Ingham, do hereby certify that the above and foregoing is a true and correct copy of Opinion entered October 24, 1933, in the above entitled cause in said Court, as appears of record in my office, and that I have compared the same with the original, and that it is a true transcript therefrom and of the whole thereof.

In Testimony Whereof, I have hereunto set my hand and affixed the seal of said Court, at Lansing, Michigan, this 9th day of November, A. D. 1934.

C. Ross Hilliard,
County Clerk.
By Irene M. Ferris,
Deputy County Clerk.

(Seal)

UNITED STATES CIRCUIT COURT OF APPEALS
FOURTH CIRCUIT.

No. 3735.

W. H. SPRADLIN, Receiver of the ELKIN NATIONAL BANK,
Appellant,

versus

ROYAL MANUFACTURING COMPANY, a corporation,
Appellee.

Appeal from the District Court of the United States
for the Middle District of North Carolina,
at Winston-Salem.

(Argued October 26, 1934. Decided November 19, 1934.)

Before PARKER, NORTHCOTT and SOPER, Circuit Judges.

JOHN J. INGLE and JOHN H. FOLGER for Appellant, and
E. C. BIVENS for Appellee.

PARKER, Circuit Judge:

This is an appeal from a decree holding a claim of the Royal Manufacturing Company for $3,483.73 to be a lien on the assets of the failed Elkin National Bank in hands of its receiver. The claim arose out of a draft on the Chatham

Manufacturing Company which was sent to the bank for collection. The company last named paid the draft by a check drawn against its deposit account with the bank, and the bank remitted for the collection by draft on one of its correspondents, but failed before this draft could be paid. There was, of course, no augmentation of the assets of the bank as a result of the collection, but merely a shifting of credits, and consequently no basis for the declaration of a trust. *Lifsey v. Goodyear Tire & Rubber Co.* (C. C. A. 4th) 67 Fed. (2d) 82, 83; *Ellerbe v. Studebaker Corporation of America* (C. C. A. 4th) 21 Fed. (2d) 993, 995; *Larabee Flour Mills v. First Nat. Bank* (C. C. A. 8th) 13 Fed. (2d) 330, 331. The learned judge below was of opinion, however, that the assets of the bank were subjected to a lien to the amount of the collection by reason of the proviso appearing in Section 218 (c) (14) of the North Carolina Code of 1927.

Section 218 (c) of the North Carolina Code is composed of twenty-three subsections all of which relate to the liquidation of state banks. Subsection 14 thereof, which contains the proviso in question, is as follows:

"(14) Declaration of Dividends; Order of Preference in Distribution.—At any time after the expiration of the date fixed by the Chief State Bank Examiner, or the duly appointed agent, for the presentation of claims against the bank, and from time to time thereafter, the Corporation Commission, out of the funds in its hands, after the payment of expenses and priorities, may declare and pay dividends to the depositors and other creditors of such bank in the order now or hereafter provided by law; and a dividend shall be declared when and as often as the funds on hand subject to the payment of dividends shall be sufficient to pay ten (10) per centum of all claims entitled to share in such dividends. In paying dividends and calculating the same, all disputed claims and deposits shall be taken into account but no dividend shall be paid upon such disputed claims and deposits until the same shall have been finally determined. The following shall be the order and preference in the distribution of the assets of any bank liquidated hereunder: (1) Taxes and fees due the Corporation Commission for examination or other services; (2) wages and salaries due officers and employees of the bank, for a period of not more than four months; (3) expenses of liquidation;

(4) certified checks and cashier's checks in the hands of a third party as a holder for value and amounts due on collections made and unremitted for or for which final actual payment has not been made by the bank; (5) amounts due creditors other than stockholders. The word 'asset' used herein shall not be deemed to include bailments or other property to which such bank has no title. Provided, that when any bank, or any officer, clerk, or agent thereof, receives by mail, express or otherwise, a check, bill of exchange, order to remit, note, or draft for collection, with request that remittance be made therefor, the charging of such item to the account of the drawer, acceptor, indorser, or maker thereof, or collecting any such item from any bank or other party, and failing to remit therefor, or the nonpayment of a check sent in payment therefor, shall create a lien in favor of the owner of such item on the assets of such bank making the collection, and shall attach from the date of the charge, entry or collection of any such funds. A statement of all dividends paid shall be filed in the office of the clerk of the Superior Court in the pending action, and said statements shall show the expenses deducted and the disputed claims and deposits considered in determining said dividend."

It is clear, we think, that even if this proviso be construed as having relation to solvent banks as distinguished from those in liquidation, it cannot affect national banks. It has been held that these banks have no power to pledge their assets to secure a private deposit (*Texas Pac. Ry. Co. v. Pottorff*, 291 U. S. 245, 253); and one of the reasons for this holding is that to permit such pledge would be inconsistent with many provisions of the national bank act which are designed to insure a ratable distribution of assets among creditors. The same reasoning would forbid the creation of a lien on assets as security for funds collected. And, of course, if the creation of such a lien be beyond the powers of the bank, it could not be created by act of the state legislature; for the legislature could not provide that action on the part of the bank should give rise to a lien which the bank, by reason of the limitations imposed upon it by act of Congress, was powerless to create.

But it is clear that the statute in question was not intended to have application to solvent banks. Quite apart from the fact that it is a proviso to one of the sub-sections of a statute dealing with the liquidation of insolvent banks,

it appears that it can have no practical application except in connection with their liquidation. The lien created, although it is to attach from the date of the charge, entry or collection, arises only upon "failing to remit" or "the non-payment of a check sent in payment"; and it is manifest that a solvent bank will not fail to remit collections or permit a check sent in payment of a collection to remain unpaid. It is only in case of banks which have failed, therefore, that the statute can have any practical application; and the lien which it creates is of such a character that it can be enforced only by a liquidation of the bank. See *Lewis v. Fidelity & Deposit Co.*, 292 U. S. 559 at 563 and 567. The statute must be construed, therefore, as relating to the distribution of assets in the hands of banks which have failed; for "in whatever language a statute may be framed, its purpose must be determined by its natural and reasonable effect." *Collins v. New Hampshire*, 171 U. S. 30, 34; *Morgan v. Louisiana*, 118 U. S. 455, 462; *Henderson et al. v. Mayor of New York*, 92 U. S. 259, 268. So construed, it can have no application to the assets of national banks; for the national banking act provides how the assets of insolvent national banks shall be distributed. 12 U. S. C. A. 194. And it is well settled that state statutes cannot affect this distribution. *Davis v. Elmira Savings Bank*, 161 U. S. 275; *Easton v. State of Iowa*, 188 U. S. 220; *Old Company's Lehigh v. Meeker* (C. C. A. 2d), 71 Fed. (2d) 280; *Fiman v. South Dakota* (C. C. A. 8th), 29 Fed. (2d) 776, 777; *First Nat. Bank of Chicago v. Selden* (C. C. A. 7th), 120 Fed. 212.

The case of *Lewis v. Fidelity & Deposit Co.*, 292 U. S. 559, relied upon by appellee, is in reality an authority against its position. In that case a statute of Georgia, creating a general lien on the assets of banks as security for deposits of state funds, was held to have application to a national bank merely because the act of Congress of June 25, 1930, c. 604, 46 Stat. 809, 12 U. S. C. A. 90, authorized a national bank to give security for a deposit of public funds of the same kind as authorized by state law for state banking institutions. The Supreme Court said that no lien under the Georgia statute arose in 1928 when the deposit was made, and that the judgment of the court below sustaining the lien would have been reversed but for the enactment by Congress of the Act of 1930. See p. 564. Here

there is no act of Congress authorizing the creation of a lien on the assets of a national bank as security for collections; and the act of the North Carolina legislature can no more create a lien on the assets of a national bank than could the Georgia statute without the aid of the act of 1930.

We do not interpret the proviso as having been intended to make the collecting bank the agent of the holder of the item sent for collection, which was the purpose of the sections of the uniform bank collection code under consideration in *National Bank of America v. U. S. F. & G. Co.* (C. C. A. 7th), 71 Fed. (2d) 618, 619, and *Old Company's Lehigh v. Meeker, supra.* Nevertheless, under the rule recognized in this Circuit, the bank here was the agent of the owner of the draft for the purpose of making the collection and remitting the proceeds. *Ellerbe v. Studebaker Corporation* (C. C. A. 4th), 21 Fed. (2d), 993, 994; *Lifsey v. Goodyear Tire & Rubber Co.* (C. C. A. 4th), 67 Fed. (2d) 82, 83. But under the authority of these cases, appellee is not entitled to have a trust declared or to receive preferential payment from the assets in the hands of the receiver, since it has failed to show that these assets have been augmented as a result of the collections.

For the reasons stated, the decree appealed from will be reversed.

Reversed.

Excerpts from the Article entitled "The Bank Collection Code of the American Bankers Association" by Wayne L. Townsend, Professor of Law, Western Reserve University, Tulane Law Review, April 1934:

Page 378:

"As Sections 2 to 10 inclusive of the Code overthrow much of the existing law of bank collections, and as Sections 4, 11 and 12 tinker with, disrupt and repeal a considerable portion of the law of bills and notes, so does Section 13 invade the field of insolvency administration and arbitrarily create a class of preferred creditors without reference to existing principles and in plain disregard of equitable doctrine and all considerations of fairness. While the first group of sections allocates collection losses arising in the collection system, as between bank and depositor, to the depositor, and although the second group (Sections 11 and 12) affords a means whereby the risks can be imposed on makers, drawers and indorsers, the present Section 13 erects a scheme by the use of which such risks and losses can be further shifted and be made to repose on the depositors (and other general creditors) of an insolvent bank, who thus become the ultimate 'goats' of the Code.

Pages 388 to 392:

It is then self-evident that 'a trust creditor merely as such has no preference over others.'[153] in the administration of an insolvent's estate. In ability to point out any asset in the possession of the insolvent as the product of the misapplied property precludes the possibility of a decree for restitution in specie.[154] Although this principle of fairness in insolvency administrat on

[153] Webb v. Newhall, 274 Pa. 135, 117 Atl. 793 (1922).

[154] "The so-called right to be preferred in case of wrongful conversion is a right of ownership—a right of property. * * * When the means of ascertainment of the identity of property or proceeds fail, the right fails." Multnomah County v. Oregon Nat. Bank, 61 Fed. 912 (C. C. Ore. 1894). "The equitable right to trace the trust fund and impress the fund with which it has been commingled or the property into which it has been merged, with the trust, is rested upon the right of property and not on a theory of preference arising from an unlawful conversion." Hanover Nat. Bank v. Thomas, 217 Ala. 494, 117 So. 42 (1928).

has had its most important applications since the decision in Knatchbull v. Hallett, 13 Ch. D. 696 (1880)[155] it has been developed by courts of equity over a long period of time.[156] But the framers of the present Code in creating the trusts of Section 13 in favor of the owners of collection items have ignored every equitable consideration and every canon of fairness which has been developed by the course of decision. Both subdivisions expressly provide for trusts extending to all the assets of an insolvent bank, without regard to the question of whether the proceeds of the item are among the bank's assets or not. In Subdivision (2), the trust is established regardless of the receipt or non-receipt by the bank of anything in substitution for the collection item. The necessity of showing that the claimant has some equitable right to or claim upon some of the bank's assets is eliminated completely. The equitable basis of preferences is wiped out and in substitution we find an arbitrary statutory fiat that a preference shall be granted under the recited circumstances for no apparent reason whatever.

Subdivision (3) is brought into operation once an intermediate collecting bank has received the proceeds of an item in any form. The situation remains unaffected by the fact that it may be shown that at the time the bank closed such proceeds had been fully dissipated or lost and never came into the hands of the liquidator.[157]. Such an imposition of trust and granting of preference cannot be condoned whether it flow from a statute or a court's lack of understanding. Under such circumstances the owner of a collection item, not settled for, has no more equitable claim upon the bank's real estate, its posting machines, its note case, its cash on hand, than has an ordinary general depositor. None of these assets bears any particular relation to the dissipated proceeds of his misappropriated property.

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[155] 13 Ch. D. 696 (1880).

[156] See Ryall v. Ryall, 1 Atk. 59 (1739).

[157] E. g., see Sanders v. Stevens, 51 F. (2nd) 743 (D. C. Miss. 1931); Dickson v. First National Bank, 26 Fed. (2nd) 411 (C. C. A. 8th 1928); Leach v. Iowa State Savings Bank, 204 Iowa 497, 212 N. W. 748 (1927); State v. Farmers State Bank, 54 Mont. 515, 172 Pac. 130 (1918); Shaw v. Lamar County, 12 S. W. (2nd) 607 (Tex. Civ. App. 1928); Titlow v. McCormick. City Bank v. Blackmore, Salem Elev. Works v. Comm., Groff v. City Savings Fd. & Tr. Co., Farmers State Bank v. Smith, all *supra* note 150.

Why then should they be devoted to making the owner of the collection item whole before depositors of the bank receive any portion of them?

Under Subdivision (2) the mere charge of the drawer's check against his account with the drawee creates the trust in all the assets of the drawee, provided the privilege of Section 11 has not been exercised. A question at once presents itself to one who gives the situation a second's thought: How has the estate of the drawee been affected by such a charge? What assets does the bank now have which it did not have before the charge? Does the bank possess an asset to which anyone, in an attitude of fairness, can say that a trust attaches? If the check is discharged the bank has of course, diminished its total indebtedness. But a diminution of indebtedness is not an increase of assets.[158] The decisions are in conflict as to the existence of a trust in the situation covered by Subdivision (2).[159] Very clearly the drawee bank has received nothing by way of addition to its assets as a result of charging the check. There was no asset upon which the owner of the collection item had any claim before the account was charged. It is difficult to see how his relations to the assets of the bank, and to its cash in particular,[160]

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[158] "If it is affirmatively shown that the misappropriated trust funds have been dissipated without directly or indirectly augmenting the estate which has come into the hands of the trustee's assignee, probably no court would impress a trust or a lien upon the assets in favor of the beneficial owner of the misappropriated property. This would usually be the case where it is shown that the trust funds were used to pay debts of the trustee." Perry v. Trusts (7th ed. 1929) 1431. "The result of the cancellation of a debt is purely negative." Bogert, loc. cit. *infra*, note 165, at p. 559.

[159] Preference denied: Burnes National Bank, Spurway, 28 F. (2nd) 40 (D. C. Iowa 1928); Leach v. City-Comml. Sav. Bank, 207 Iowa 1254, 219 N. W. 496, 224 N. W. 583 (1928); People v. Merchants & Mech. Bank, 78 N. Y. 269 (1879); N. C. Corp. Comm. v. Mchts. & Farmers Bank, 137 N. C. 697, 50 S. E. 308 (1905); Shull v. Beasley, 149 Okl. 106, 299 Pac. 149 (1931); cf. Security Tr. & Sav. Bank v. Button, 7 Pac. (2nd) 245 (1932). Preference granted: Griffith v. Burlington State Bank, 128 Kan. 279, 277 Pac. 42 (1929); State v. Nebr. State Bank, 120 Neb. 539, 234 N. W. 82 (1931); Central Trust Co. v. Bank of Mullens, 108 W. Va. 12, 150 S. E. 137 (1929). And see Bank of Republic v. Republic State Bank, 42 S. W. (2nd) 27 (Mo. 1931); Federal Reserve Bank v. Peters, 139 Va. 45, 123 S. E. 379 (1924).

[160] Such trusts are usually alleged only against the cash on hand at time of closing on the ground that the transaction is equivalent to the bank segregating part of such cash in a separate fund, contemporaneously with charging the check to the drawer's account and for the purpose of securing the payment of same; or that charging the check is the same as cashing the check at one window and paying it back into the bank at another.

are any different after the charge. The proposition has been advanced that a bank's relation to its cash is changed from that of outright owner to that of trustee by debiting (or agreeing to debit) a depositor's account and promising to use funds debiting (or agreeing to debit) a depositor's account and promising to use funds in the amount of the debit for specified purposes of the depositor.[161] The quietus was placed upon any such doctrine at least for the Federal courts, by the Supreme Court in Blakey v. Brinson,[162] where it is stated that 'The cancellation of the credit balance by the debit neither suggests any intention to establish a trust nor points to any identifiable thing which could be the subject of it". How, then, accord any greater efficiency in the establishing of a trust res to the bank's charge of a collection item to the drawer's account? But Subdivision (2) establishes a trust in such a case which not only covers that against which a trust is usually asserted, cash on hand, but extends to all the assets of the failed bank. Neither reason nor previous authority gives any sound basis for the creation of the statutory trust in such a case.[163]

The provisions of the Code shift the incidence of risk successively from one class of bank-related persons to another. As between owner of a collection item and a collecting bank, losses are in general allocated to the owner, where they no doubt properly belong. Next, the risk is shifted to parties to an instrument and away from the owner (Section 11), a solution the desirability of which is much more uncertain. Finally, the burden of losses may be made to rest ultimately upon the general depositors of a failed bank, an imposition which is indefensible. What has impelled the framers

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[161] Davis v. McNair, 48 Fed. (2nd) 494 (C. C. A. 5th 1931). And see Fagan v. Whidden, 57 Fed. (2nd) 631, 632 (C. C. A. 5th, 1932). Contra; Mark v. Westlin, 48 Fed. (2nd) 609 (D. C. Minn. 1931). See dicta in City of Miami v. First Nat. Bank, 58 Fed. (2nd) 561 (C. C. A. 5th 1932), considered in Comment, 6 Tulane L. Rev. 643 (1932).

[162] 286 U. S. 254, 52 Sup. Ct. 516 (1932).

[163] Louisiana Act 63 of 1926, Sec. 2, accords a privilege to a forwarder-bank under the conditions of Subdivision (2), where the drawee also issues a draft in settlement. The criticism of the writer must extend to those legislative acts, other than the Code presently considered, which on the whole give a claimant the same position as does Subdivision (3). See Ga. Ann. Code (Michie Supp. 1928) Sec. 2366 (70); La. Act 63 of 1926, Sec. 1; Throckmorten's Ann. Code of Ohio, Sec. 712, 713, 714.

of the Code to provide so well for the mulcting of ordinary bank creditors? No explanation is forthcoming except the statement in the draftsman's Explanatory Notes that "the purpose of this section is to establish uniform rules based on the better reasoned decisions." The impertinence of such an assumption makes any commentary unnecessary. But it might be to the point to ask whether the fact that depositors are a non-cohesive group whose interests are represented always by a liquidator not especially enthusiastic about his duty of opposing specific preference claimants has affected the draftsman in the decision to force burdens upon a relatively unresisting class as it has affected courts desirous of avoiding the mental strain of thinking the matter through? It is such an easy solution of what appears otherwise to be a difficult problem.

It has been suggested that the owners of collection items have some vague "equity" to be treated differently than ordinary depositors, even though they cannot show that the insolvent bank has improved its asset position by the use of their items, because some risks have by statute or contractual agreement been placed upon such owners in their relations with others. Why such a change in the allocation of risk as between owner and the forwarding bank ought to affect the rights of general creditors, the writer cannot understand. The matter has been treated in a previous volume of this Review and repetition seems unnecessary.[164] Professor Bogert has classified the policy bases upon which statutory preferences have usually been founded, apart from the conventional express or constructive trust concept.[165] None of such policy considerations are present in the situations comprehended

[164] See Comment, 6 Tulane L. Rev. 657-659 (1932).

[165] Preferred debts are usually created by statute in the administration of the estates of deceased persons, insolvents, and the like, for one of four reasons, namely: (1) to care for the expenses of the administration of the estate; (2) to satisfy governmental claims; (3) to pay persons who have rendered particularly meritorious services or have particularly meritorious claims, as in the case of funeral expenses, expenses of the last illness, or claims of a widow or children; and (4) to secure payment to those in a low economic position as, for example, laborers, household servants and the like. It would not seem that the depositor of the item for collection deserves preference on any of these grounds." Bogert, Failed Banks, Collection Items, and Trust Preferences, 29 Mich. L. Rev. 545, 564 (1931). As to other suggestions re the allocation of collection risks, see same article.

by Section 13. Why, then, by a process of statutory attrition waste away the insolvent estate from which the ordinary depositor will in any event obtain such slight satisfaction?

Section 13 would be sufficient to damn the Code as a whole, even though it possessed no other defects. But the Code contains so little that can be favorably commented on that this little is lost in the overwhelming crush of the unjustified. Further than those portions which place collection risks upon the owners of collection items, approval cannot go. The attempt to disrupt the law of negotiable instruments looks to effects which should be avoided—radical and unnecessary changes in a fairly well settled field (presentment and notice of dishonor) and the substitution of rules whose most outstanding characteristics are unintelligible definition and lack of circumscription (Sections 11 and 12) No reasons whatsoever are advanced to show that th law of change of position in the quasi-contracts ar agency fields does not work justice; nor is any justif cation attempted for the existence of one rule relating to change of position in the bank collection cases and a different rule in other agency situations. The repeated use of terms which have no definition of any kind in the Code and which have only a vague meaning for both layman and lawyer can scarcely be expected to develop the substantive law in a uniform manner. To climax the comedy of errors, Section 13 distributes preferences on arbitrary factual bases which have no more relation to the equities of an insolvency situation than had the fecundity of Henriette D'Entragues to the welfare of the state."